Commission infringement procedure targets Dutch LOB clause

The EU Commission has commenced infringement proceedings against the Netherlands, contending that the limitation on benefits clause in its double tax treaty with Japan breaches EU fundamental freedoms.

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<td>Contact</td>
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The EU Commission has released details of infringement proceedings it has launched against the Netherlands concerning the scope of the limitation on benefits (LOB) clause contained in the Netherlands/Japan double tax treaty. The Commission is requesting the Netherlands to amend the terms of the LOB clause to make it compatible with EU fundamental freedoms.

The Commission’s infringement proceedings throws into sharp relief the difficulties that Member States may have in implementing the OECD’s recommendations on treaty abuse in a way that remains compatible with fundamental EU principles.

**Background**

The Netherlands/Japan double tax treaty entered into force on 01 January 2012. The treaty provides for a lower or 0% rate of withholding tax on certain investment income, such as dividends, interest and royalties. However, the treaty includes an LOB clause and anti-conduit provisions. The LOB clause limits the availability of certain treaty benefits (including the 0% withholding tax rates on dividends, interests and royalties) to “qualifying persons” (see below).

**Infringement proceedings**

The European Commission has now asked the Netherlands to amend the LOB clause in the Netherlands/Japan treaty.

The Commission takes the view that, on the basis of ECJ caselaw such as Gottardo (Case C-55/00) and Open Skies (Case C-466/98), a Member State concluding a treaty with a third country cannot agree better treatment for companies held by shareholders resident in its own territory, than for comparable companies held by shareholders who are resident elsewhere in the EU/EEA. Similarly, a Member State cannot agree better conditions for companies traded on its own stock exchange than for companies traded on stock exchanges elsewhere in the EU/EEA. To do so is in breach of the fundamental freedoms.

However, the Commission notes that under the current terms of the LOB clause, some entities are excluded from the
benefits of the tax treaty in a discriminatory fashion. This means that they suffer higher withholding taxes on dividends, interest and royalties received from Japan than similar companies with Dutch shareholders or whose shares are listed and traded on the Dutch stock exchange. (This is the case even though the current LOB clause also recognises certain foreign stock exchanges, which include a number of EU and even third-country stock exchanges.)

**Comment**

The Commission's request takes the form of a reasoned opinion. In the absence of a satisfactory response within two months, the Commission may refer the Netherlands to the ECJ.

If the Commission’s arguments are upheld, the Netherlands will be required to amend the LOB clause included in the Netherlands/Japan treaty and any other treaties taking the same approach.

More generally, of course, this infringement procedure throws into sharp focus possible EU fundamental freedom concerns surrounding the use of LOB clauses by Member States generally. This is particularly significant in the light of the OECD’s recommendations under BEPS Action Point 6, which suggest the wide use of LOB clauses in double tax treaties to prevent treaty abuse.

**The Netherlands/Japan LOB clause: qualifying persons**

A resident of a Contracting State is a qualifying person if it falls (for at least a prescribed minimum period) into one of the following categories of persons: (i) individuals; (ii) Japan or the Netherlands or a political subdivision or local authority thereof, the Bank of Japan, the Central Bank of the Netherlands or certain government institutions; (iii) listed or registered companies (for certain companies the primary place of management and control should be in the Contracting State of which it is resident); (iv) certain exempt pension funds, charities and financial institutions (regulated in the Contracting States in which they are resident); and (v) persons other than individuals, if shares or other beneficial interests representing at least 50% of their voting power are, directly or indirectly, held by residents of either Contracting State that are qualifying persons.

If a person is not a qualifying person, it may nevertheless qualify for the Treaty benefits if it meets the requirements of any of the following tests:

- the derivative benefits test: at least 75% of the voting power of a resident company is held, directly or indirectly, by seven or less "equivalent beneficiaries"
- the active trade or business test: where a resident company carries on a business in the Contracting State of its residence (with certain exclusions) and the relevant item of income is derived in connection with, or is incidental to, that business, or
- the headquarters company test: where a resident company functions as a headquarters company for a multinational corporate group and the item of income derived from the other Contracting State is either derived in connection with, or is incidental to the multinational business of the group.

A resident of a Contracting State that is not a qualifying person, and also does not meet any of the tests as described above, will still be entitled to the Treaty benefits if the competent authority determines, in accordance with its law or administrative practice, that the obtaining of such benefits is not one of the main purposes of the establishment, acquisition or maintenance of the resident entity or the conduct of its operations.
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